GREYCOURT

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As many of you have heard or seen, President Trump amplified the pressure on Chinese trade negotiators this morning by tweeting that “there is absolutely no need to rush” the negotiations with the Chinese and that the United States will impose 25% tariffs on $325 billion of Chinese goods that are not currently being taxed. Several Greycourt clients have inquired about the negotiation dynamics and investment implications of this recent news.

With respect to negotiation, we’re watching the President employ classic Art of the Deal tactics to carefully assemble negotiating leverage. The increased tariffs on Chinese goods don’t go into effect for a few weeks, and the new tariffs don’t apply to goods in transit which leaves ample time to hammer out a compromise and contemplate the consequences of failure. For over a week, three U.S. Navy guided-missile destroyers have been operating in the South China Sea, and yesterday the United States seized a massive Korean coal freighter. None of these events or their timing is mere happenstance.

Economic analysis centers on the impact of raised tariffs on Chinese growth and US inflation. As markets gauge the duration of tariffs and the likelihood of successful negotiations, there’s no question that Chinese companies are more vulnerable than US companies. Markets revealed their view earlier in the week as stocks in China fell significantly more than in the US. Likewise, markets with more exposure to China were hit harder, too. Technical factors today have caused Chinese stocks to jump and the US dollar is off somewhat. Day-to-day events are interesting, but the longer trend is what really matters.

Longer term, goods trade is slowing, even as trade in services is accelerating, reflecting a decade-long transition in the nature of globalization. Importantly, less than 20% of goods trade today is labor-cost arbitrage. As a result, protracted or failed negotiations could dramatically alter the location of production globally, intellectual property, and lead to civil unrest in China. Because of these significant risks, and greater downside to China, markets anticipate a positive resolution, which bodes negatively for markets if negotiations ultimately fail.

The set of scenarios, and the inherent uncertainty involved, reinforces the need for thoughtful portfolio diversification and manager selection. Because we’ve positioned portfolios for a range of outcomes, Greycourt is not advising material changes at this time. It is important to consider the possibility that, complex as the trade negotiations have already been, this episode could simply be the beginning of a fundamental reassessment of the West’s relationship with China. No one knows for sure, but we expect our portfolios and managers to evolve with, and exploit, changing market circumstances.

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